

# SUMMARY ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Machado Analyst: Colin Stevens Bill Number: AB 2221

Related Bills: \_\_\_\_\_ Telephone: 845-3036 Amended Date: 5/13/98

Attorney: Doug Bramhall

Sponsor: \_\_\_\_\_

**SUBJECT:** Internet Service Provider Tiering, Filtering System, Gateway Scanning Credit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

☒ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 23, 1998, STILL APPLIES.

OTHER - See comments below.

### SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and Bank and the Corporation Tax Law (B&CTL), this bill would allow a credit to taxpayers who are qualified Internet service providers (ISPs). The credit would be equal to an applicable percentage of costs paid or incurred by the taxpayer for the purchase and installation of a tiering or filtering system, or a gateway scanning device, as defined, that is placed on the ISP's web server, but could not exceed \$50,000 per taxpayer per year.

### SUMMARY OF AMENDMENT

The May 13, 1998, amendments:

- Provide that the credit would equal the "applicable percentage" of costs paid or incurred. The "applicable percentage" would be equal to 75% of the first \$10,000 (\$7,500 in allowable credit) and 50% of costs in excess of \$10,000 but not in excess of \$50,000.
- Require that a qualified Internet service provider be domiciled in this state.

Other than the amendments described above, the resolution of the policy concern regarding 100% credit identified in the department's analysis of the bill as amended April 23, 1998, a new policy and technical concern identified below and the revised revenue estimate, the department's analysis of the bill as amended April 23, 1998, still applies. The implementation consideration identified in the department's analysis of the bill as amended April 23, 1998, still applies and is restated below.

### Policy Considerations

This bill conditions the receipt of the credit on taxpayers being domiciled in this state. The result may be viewed as an indirect subsidy to local

### Board Position:

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Department/Legislative Director

Date

Johnnie Lou Rosas

6/17/98

(California) business which discriminates against interstate commerce. As such, it may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

While the addition of a percentage cost limitation eliminates the 100% of cost credit issue, it is still unprecedented at the state level to allow 75% of costs to qualify as a credit amount.

#### Implementation Considerations

Further clarification of the definition for a "web server" would help to ensure that disputes do not arise between taxpayers claiming the credit and the department as to qualifying expenditures.

#### Technical Considerations

The "applicable percentage" would allow a maximum credit of \$27,500 since the applicable percentage would be equal to 75% of the first \$10,000 (\$7,500 in allowable credit) and 50% of costs in excess of \$10,000 but not in excess of \$50,000 (\$20,000 in allowable credit) for a total maximum credit amount of \$27,500. However, according to staff at the author's office, the maximum credit amount was intended to be \$50,000. Amendments 1 and 2 would clarify that the applicable percentage would be 75% of the first \$10,000 and 50% of costs between \$10,000 and \$95,000, for a total annual maximum credit of \$50,000.

### FISCAL IMPACT

#### Tax Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows in applied credits.

Estimated Revenue Impact AB 2221		
Effective for Income Years		
Beginning After 12/31/97		
Fiscal Year Impact		
(In Millions)		
1998-9	1999-0	2000-01
(\$0.5)	(\$1)	(\$1)

This analysis does not account for any changes in employment, personal income, or gross state product that might result from this proposal.

#### Tax Revenue Discussion

Revenue losses under this bill would depend on the number of ISPs (Internet Service Providers) that purchase and install a tiering or filtering system or a gateway scanning device, the cost of that system, and the ability of the ISP to apply credits generated.

As the bill is written, the maximum allowable credit is ambiguous, with a maximum allowable credit of either \$50,000 or \$27,500 per taxpayer per year.

However, since staff at the author's office has indicated that the maximum credit is intended to be \$50,000 per taxpayer per year, that number was used to calculate revenue losses under this bill.

According to industry sources, costs for a tiering or filtering system or a gateway scanning device can vary significantly, depending on the number of users, and the type and degree of filtering offered.

According to the same sources, approximately 500 ISPs are located in California, of which approximately 80% are estimated to be domiciled in the state. Revenue estimates above assume 10% of existing ISPs domiciled in California would qualify annually for the credit for an average credit of approximately \$27,000. In addition, the estimate assumes that new business entities specifically formed to provide filtering access service to the Internet would match qualifying expenses of existing ISPs. To allow for available tax liabilities and the tentative minimum tax interaction, it was assumed that approximately 60% of credits generated would be used over three years.

Finally, adjustments were made to account for the offsetting tax effect of deductions that would be otherwise allowed under current law.

#### BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 2221  
As Amended May 13, 1998

AMENDMENT 1

On page 3, strike line 23 and insert:

not in excess of ninety five thousand dollars (\$95,000).

AMENDMENT 2

On page 5, strike line 18 and insert:

not in excess of ninety five thousand dollars (\$95,000).